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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 728

EDNA B. ELIAS,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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Of Counsel.

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INDEX.

PETITION

	PAGE
Opinion Below	2
Jurisdiction	2
Statement	2
Questions Presented	8
Statutes Involved	9
Reasons for Granting the Writ	10

BRIEF IN SUPPORT OF PETITION

Statement	15
Specifications of Errors to Be Urged	15
Summary	17
Argument	17
I—In holding that the petitioner was taxable under sec. 22(a) without the retention by her of any control over the trust funds, the decision of the Court below is in conflict with the decision of this Court in *Helvering* v. *Clifford*.	17
II—In so far as the Court below held that the control factor for the purposes of sec. 22(a), should be inferred from the relationship between the petitioner and the trustee, her husband, notwithstanding that the Board, upon substantial evidence, had found to the contrary, the Court below exceeded its jurisdiction	20

PAGE

III—Sec. 166 of the Revenue Act of 1934 was not applicable to these trusts for the years 1934 and 1935; if construed to be so applicable it would to that extent contravene the Fifth Amendment to the Constitution..... 24

Sec. 166 of the Act of 1934 does not apply where, as in this case, during the tax years the power to revoke was not exercisable but contingent 24

If construed to apply to the present situation where the trusts were created five years before the Act of 1934, Sec. 166 would have a retroactive effect and would impose an arbitrary and unreasonable Tax in violation of the Fifth Amendment to the Constitution 26

IV—The capital gains for 1934 and 1935 were not taxable to the petitioner under Sec. 167; to construe this section in the Act of 1934 to tax such gains to petitioner would give the statute an effect in conflict with the Fifth Amendment. 29

The capital gains for 1934 and 1935 were not taxable to the petitioner under Sec. 167, because in those years it could not be determined who would ultimately become entitled to such gains..... 29

The application of Sec. 167 of the Act of 1934 to the capital gains from these trusts for 1934 and 1935, would give the statute a retroactive effect and would impose an arbitrary and unreasonable tax in contravention of the Fifth Amendment..... 33

CONCLUSION 35

APPENDIX 37

CASES CITED:

PAGE

Altmaier v. *Commissioner*, 116 F. (2d) 162 (C. C. A.—6), Cert. denied 312 U. S. 706.....12, 32

Blodgett v. *Holden*, 275 U. S. 142.....11, 13, 27, 34

Commissioner v. *Barbour*, 122 F. (2d) 165 (C. C. A.—2) 18
Commissioner v. *Buck*, 120 F. (2d) 775 (C. C. A.—2). 18
Commissioner v. *Grosvenor*, 85 F. (2d) 2 (C. C. A.—2) 12, 31
Commissioner v. *Jonas*, 122 F. (2d) 169 (C. C. A.—2). 18
Commissioner v. *Prouty*, 115 F. (2d) 331 (C. C. A.—1) 22
Commissioner v. *Waterbury*, 97 F. (2d) 383 (C. C. A.—2), cert. denied 305 U. S. 638.....12, 29, 30, 31
Commissioner v. *Woolley*, 122 F. (2d) 167 (C. C. A.—2) 18
Commissioner v. *Yeiser*, 75 F. (2d) 956 (C. C. A.—6).21, 22
Corning v. *Commissioner*, 104 F. (2d) 329 (C. C. A.—6) 11, 12, 24, 25, 32

Eisner v. *Macomber*, 252 U. S. 189.....13, 34

Gibbons v. *Mahon*, 136 U. S. 549.....13, 34
Gladding v. *Follett*, 2 Dem. Surr. 58 affirmed 30 Hun 219, affirmed 95 N. Y. 652..... 21
Graff v. *Commissioner*, 117 F. (2d) 247 (C. C. A.—7) 12, 32

Harrison v. *Schaffner*, 312 U. S. 579..... 20
Hassett v. *Welch*, 303 U. S. 303.....11, 13, 27
Helvering v. *Campbell*, 313 U. S. 15.....12, 32
Helvering v. *Clifford*, 309 U. S. 331, 6, 7, 8, 10, 16, 17, 18, 19, 20, 23, 26
Helvering v. *Dunning*, 118 F. (2d) 341 (C. C. A.—4), cert. denied Oct. 13, 1941.....11, 25
Helvering v. *Hallock*, 309 U. S. 106.....12, 32
Helvering v. *Helmholz*, 296 U. S. 93.....11, 13, 27, 34
Helvering v. *Richter*, 312 U. S. 561..... 20

PAGE

Helvering v. *Wood*, 309 U. S. 344 ..... 25, 26
Hoeper v. *Tax Commission*, 284 U. S. 206 ..... 11, 13, 28, 34
Hormel v. *Helvering*, 312 U. S. 552 20

Kent v. *Rothensies*, 120 F. (2d) 476 (C. C. A.—3), cert. denied Oct. 13, 1941 12

Laumeier v. *Laumeier*, 237 N. Y. 357 21
Lyons Estate, 137 N. Y. Supp. 171 21

Nichols v. *Coolidge*, 274 U. S. 531 ..... 11, 13, 28, 34

Reinecke v. *Smith*, 289 U. S. 172 28
Reuter v. *Commissioner*, 118 F. (2d) 698 (C. C. A.—5) 11, 25

Savage v. *Commissioner*, 82 F. (2d) 92 (C. C. A.—3). 21

United States v. *Stroop*, 109 F. (2d) 891 (C. C. A.—6) 12, 29, 31

STATUTES CITED:

Internal Revenue Code:
Sec. 1141(a) 2
Sec. 1141(c) (1) 10, 23, 38

Judicial Code:
Sec. 240(a) 2

Revenue Act of 1919:
Sec. 402(c) 28

Revenue Act of 1924:
Sec. 219(g) 28

Revenue Act of 1926:
Sec. 302(d) 27

Revenue Act of 1928:
Sec. 166 38
Sec. 167 ..... 30, 31, 38

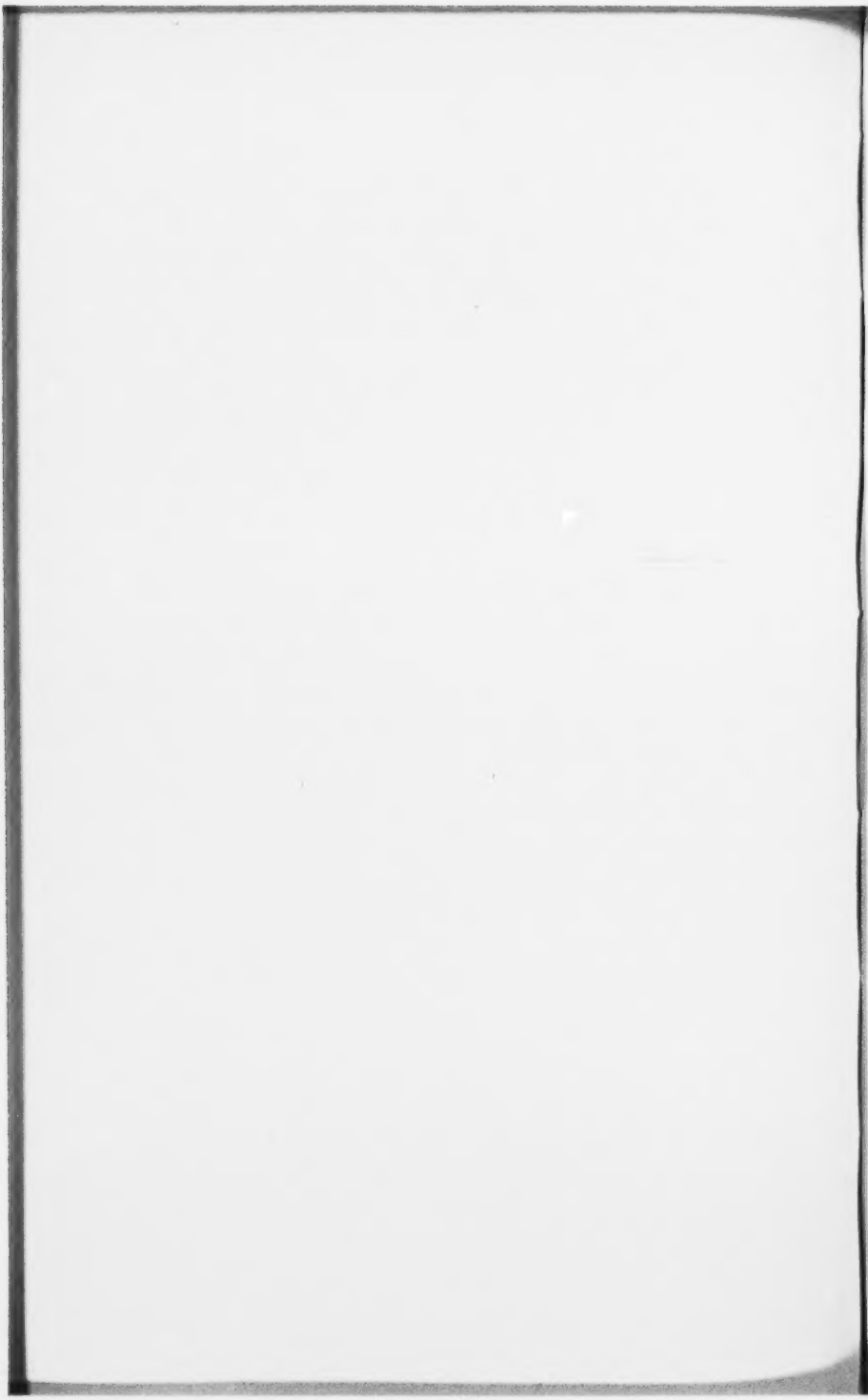
PAGE

Revenue Act of 1932:
Sec. 166 ..... 25, 39
Sec. 167 ..... 31, 32, 34

Revenue Act of 1934:
Sec. 22(a) 6, 7, 8, 10, 15, 16, 17, 18, 20, 21, 23, 25, 37
Sec. 166,
6, 7, 8, 9, 10, 11, 12, 16, 17, 24, 25, 26, 28, 29, 32, 37
Sec. 167 ..... 6, 7, 9, 12, 16, 17, 29, 30, 31, 32, 33, 34, 37

CONGRESSIONAL RECORD CITED:

Vol. 78, pp. 7823-4 39
Vol. 78, pp. 7831-2 40



IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. .

EDNA B. ELIAS,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, Edna B. Elias, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered in the above cause on August 21st, 1941 (R. 160-1), after denial of a petition for rehearing by order entered on the same day (R. 159-160), affirming on the petitioner's appeal, and reversing on the respondent's appeal, the order of the United States Board of Tax Appeals entered on June 22nd, 1940 (R. 69), which confirmed in part and expunged in part deficiencies in income tax asserted against petitioner for the years 1934 and 1935 (R. 145).

Opinion Below.

The opinion of the Circuit Court of Appeals is reported in 122 Fed. (2d) 171, and printed in the record (R. 145-8). The Opinion of the Board of Tax Appeals is reported in 41 B. T. A. 1109, and printed in the record (R. 52-67).

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on August 21st, 1941, reviewing a decision of the Board of Tax Appeals (R. 160-1).

The jurisdiction of this Court is based upon Section 240(a) of the Judicial Code as amended by the Act of February 13th, 1925, and upon Section 1141(a) of the Internal Revenue Code.

Statement.

This case involves petitioner's asserted tax liability with respect to the income for the years 1934 and 1935 from four trusts created by her.

The findings of the Board of Tax Appeals (R. 52-67), and the provisions of the trust instruments which were received in evidence (in ev., R. 96; printed, R. 115-134), may be summarized as follows:

On July 1st, 1929, in the City of New York, the petitioner, as grantor, executed four deeds of trust whereby she transferred to her husband, Henry Hart Elias, as Trustee, four trust funds of $25,000 each, creating four separate trusts, one for the benefit of each of their four children, Albert Jay Elias, Jose-

phine Elias, Robert Henry Elias and Catherine Elias (R. 53).

The children were all infants then and through the tax years 1934 and 1935, except that Robert Henry Elias attained his majority on September 17th, 1935 (R. 53; 59).

The four trust instruments (received in evidence, R. 96, and printed, R. 115-134) were alike so far as material here (R. 54).

Taking the trust for Albert J. Elias as an example, the husband, the trustee, was empowered to invest the trust fund and collect the income and use and expend the net income, or so much thereof as he in his sole discretion should deem advisable, for the support and education of the beneficiary until the latter should attain his majority, whereupon the Trustee was to pay over to the beneficiary all accumulated and unexpended income of the trust (R. 54; 115-6). Thereafter the annual net income was to be paid to the beneficiary until the death of either the beneficiary or the petitioner at which time the trust was to terminate and the remaining principal was to be paid to the husband to be his absolute property (R. 54; 116). But if the husband should predecease both the beneficiary and the petitioner, the trust was to continue and the annual net income was to be paid to the beneficiary until the death of the beneficiary, whereupon the remaining principal was to be paid over to the petitioner if then living, otherwise to others (R. 54; 116).

It was further provided that during the lifetime of the husband, Henry Hart Elias, he should be the sole trustee with the following powers: absolute discretion as to the character of investments; power to borrow from the trust fund at 4% interest; power to do

everything in the management and investment of the trust fund which an individual can do with his own property (R. 54-6; 117); power to apply and expend such part of the principal as in his (the husband's) judgment should be advisable for the support and education of the beneficiary during the latter's minority, in the event that in his judgment the income should be insufficient for such purpose, and in his sole discretion to make such application and expenditure of the income and of such part of the principal as he should deem advisable, directly to or for the purpose of the support and education of the beneficiary without the intervention of a legally appointed guardian (R. 55; 119).

But such powers were bestowed only upon the husband; they were not to devolve upon any substitute or successor trustee or trustees (55-6; 117; 119-120).

Henry Hart Elias, the husband, was at all times financially able to support the children (R. 60). He had a substantial adverse interest in the disposition of the corpus and income (R. 63).

Substitute trustees were appointed to act in case of the husband's death before the termination of the trust (R. 56-7; 120), but that contingency did not arise, and the husband continued as the sole trustee during the life of the trusts (R. 53).

In each trust instrument it was also provided that the grantor (the petitioner) reserved to herself the right to revoke the instrument at any time after January 15, 1936, upon 30 days' previous notice to the then acting Trustees, and that until said January 15th, 1936, the trust should be absolutely irrevocable (R. 56; 121).

The husband as trustee administered the trusts as valid separate trusts (R. 57).

None of the ordinary trust income (interest and dividends) was ever paid or applied, directly or indirectly to or for the benefit of the petitioner (R. 59).

Such income (interest and dividends) from each trust was deposited in an account kept in the name and for the beneficiary, and so much thereof as the husband deemed advisable was applied to the support and education of the beneficiary, and the unexpended balance was held in such beneficiary account (R. 57-8).

Capital gains were treated as part of principal; they were not segregated, but were intermingled, invested and held with the rest of the principal funds of the trust (R. 57). The capital gains were reported by the husband as income of the trust, and the tax thereon was paid from trust principal (R. 57).

The ordinary income (interest and dividends) was included in personal tax returns filed on behalf of each beneficiary, and the tax thereon was paid from his or her funds (R. 57-8).

When one of the beneficiaries, Robert Henry Elias, attained his majority on September 17th, 1935, all the unexpended income in his beneficiary account was paid over to him, and thereafter all income was paid over to him as it was received from his trust fund (R. 59).

On February 3, 1936, the petitioner gave notice of revocation of the four trusts, which became effective thirty days later on March 4th, 1936 (R. 59).

Thereupon the principal of each trust fund, which included gains on sales theretofore made, was paid over to the petitioner (R. 59). But none of the ordinary income, interest or dividends, was paid to her; on the contrary, all interest received or accrued and all dividends declared or paid on each trust fund prior

to March 4th, 1936, was set apart for the beneficiaries who were still minors, and such income from the Robert Henry Elias trust was paid over to him (R. 59). Thereafter when Josephine Elias attained her majority on December 28, 1938, the balance of the income of her trust was paid over to her (R. 59).

The respondent, in his notice of deficiency, added to the petitioner's returns for 1934 and 1935 the interest, dividends and capital gains for those years, on the ground that the income from these trusts was taxable to her under *Sections 166 and 167* of the Revenue Act of 1934, and asserted against her tax deficiencies of $6,664.68 for 1934 and $6,566.51 for 1935 (R. 21; 23-5; 58).

Upon appeal by petitioner, the Board of Tax Appeals held (R. 60-7):

(1) That the petitioner was not taxable upon the ordinary trust income pursuant to *Section 22(a)* under the doctrine of *Helvering* v. *Clifford,* 309 U. S. 331, because she retained no powers of control over the corpus, since she appointed as trustee not herself, but her husband, vesting in him all powers of management, and he clearly had a substantial adverse interest in the disposition of both corpus and income (R. 61-3);

(2) that petitioner was also not taxable under Section 166 of the Act of 1934, because in the tax years 1934 and 1935 the power of revocation was not exercisable, but was contingent upon the continuance of the trust until after January 15th, 1936, by the survival of herself and the beneficiary, and that hence the power was not vested as required by the statute (R. 64-5); but

(3) that petitioner was taxable upon the capital gains pursuant to Section 167 (R. 65-7).

Accordingly the Board redetermined the tax deficiencies, based upon the capital gains, at $1,612.74 for 1934, and $410 for 1935 (R. 69).

The respondent and the petitioner each appealed to the Circuit Court of Appeals. The Court held (R. 145-8):

(1) That, although the petitioner "surrendered all control of these funds and all income arising from them for a period of six years, six months and fifteen days" (R. 146), nevertheless, viewing these as term trusts for 6½ years, the control factor necessary to bring the case within Sec. 22(a) as construed in *Helvering* v. *Clifford,* was deemed to be present as a matter of law because of the limited period of the trusts (R. 146-7);

(2) that moreover in the present case, from the petitioner's relationship with the Trustee, her husband, it should be inferred that he would comply with her wishes as to the disposition of the trust funds, so that she should be deemed to be in control for the purposes of Sec. 22(a) (R. 147-8);

(3) that since it was decided that petitioner was taxable under Sec. 22(a), it was not necessary to determine whether she was taxable under Secs. 166 and 167 (R. 146); and

(4) that the order of the Board should be affirmed on the taxpayer's appeal, and reversed on the Commissioner's appeal (R. 148; 161).

Questions Presented.

1. Was the petitioner taxable under Sec. 22(a) of the Revenue Act of 1934 upon the income for the years 1934 and 1935 from the trusts here involved, even though petitioner had surrendered all control of these trust funds during the period from July 1, 1929, to January 15, 1936?

2. Was the Court below justified in holding that the petitioner was taxable under Sec. 22(a) of the Revenue Act of 1934 upon the income for the years 1934 and 1935 from these trusts, on the ground that the control factor to bring the case within the doctrine of *Helvering* v. *Clifford,* should be inferred from the relationship between petitioner and the trustee, her husband, notwithstanding that the Board of Tax Appeals, with evidence in support thereof, had found that the husband had a substantial adverse interest in the disposition of both corpus and income, that the petitioner had retained no powers of control over the corpus of the trusts during the period ending January 15th, 1936, and concluded that she was not so taxable pursuant to Section 22(a)?

3. Was the Court below justified in reversing the Board and holding that the petitioner was taxable under Sec. 22(a) of the Revenue Act of 1934 upon the income for the years 1934 and 1935 from the Trusts here involved?

4. Did the Court below err in failing to consider Sec. 166 of the Revenue Act of 1934 and to hold that the petitioner was not taxable under that Section upon the income for 1934 and 1935 from these trusts?

5. Did the Court below err in failing to consider Sec. 166 and to hold that the application to these trusts for the years 1934 and 1935, of Sec. 166 as amended in the Act of 1934, would give the statute a retroactive effect upon a previously closed transaction, and would impose an arbitrary and unreasonable tax, especially with respect to the ordinary income, amounting to the taking of petitioner's property without due process of law in violation of the Fifth Amendment to the Constitution of the United States?

6. Did the Court below err in failing to consider Sec. 167 of the Revenue Act of 1934 and to hold that the petitioner was not taxable under that section upon the capital gains for the years 1934 and 1935 from these trusts?

7. Did the Court below err in failing to consider Sec. 167 of the Revenue Act of 1934 and to hold that the application of that section to tax the petitioner upon the capital gains from these trusts for the years 1934 and 1935, would give the statute a retroactive effect upon a previously closed transaction and would impose an arbitrary and unreasonable tax amounting to a taking of petitioner's property without due process of law in violation of the Fifth Amendment to the Constitution of the United States?

Statutes Involved.

The statutes involved are set forth in the Appendix, *infra,* pages 37-39.

Reasons for Granting the Writ.

1. In holding that, in the case of trusts for six and a half years, such as these were considered to be, the income therefrom for 1934 and 1935 was taxable to the grantor as a matter of law, pursuant to Sec. 22(a), without the retention by the grantor of any control or management of the trust funds, the Court below has decided an important question of Federal law in a way in conflict with the decision of this Court in *Helvering* v. *Clifford,* 309 U. S. 331, *335-6.* There, in sustaining the application of Sec. 22(a) to a five year term trust, this Court emphasized the grantor's retention of legal control of the trust funds as a basic factor in the decision.

2. In so far as the decision of the Court below, that this case came within Sec. 22(a), was based upon an inference from the relationship between the petitioner and the trustee, her husband, notwithstanding that the Board, with evidence in support thereof, had found that the husband trustee had a substantial adverse interest in the disposition of both corpus and income, that the petitioner had reserved no power of control over the corpus and that Section 22(a) did not apply, the decision of the Court is not warranted by the findings of the Board, and the Court below exceeded its jurisdiction by undertaking to decide questions and make findings of fact, a function which is vested in the Board exclusively. *Internal Revenue Code,* Sec. 1141(c); *Helvering* v. *Clifford, supra,* pages *336, 338.*

3. The question as to whether the petitioner was taxable under Section 166 of the Revenue Act of 1934

upon the income for 1934 and 1935 from these trusts, which were revocable six and a half years after their creation provided that the trusts continued so long depending upon the survival of both the petitioner and the beneficiary, is an important question of Federal law, concerning which the Circuit Courts of Appeals are not in agreement. In *Corning* v. *Commissioner,* 104 F. (2d) 329 (C. C. A.—6), it was indicated that Sec. 166 of the Act of 1934 would not apply in such a case. But in *Reuter* v. *Commissioner,* 118 F. (2d) 698 (C. C. A.—5), and *Helvering* v. *Dunning,* 118 F. (2d) 341 (C. C. A.—4), cert. denied Oct. 13, 1941, on slightly different facts a contrary result was reached, although in the latter case the Court distinguished *Corning* v. *Commissioner,* and moreover expressed some doubt as to the constitutionality of applying Sec. 166 to such a situation.

The question has not been but should be settled by decision of this Court.

4. The question as to whether Sec. 166 as amended in 1934 may be applied to tax the petitioner upon the income for 1934 and 1935 from these trusts, created in 1929, without giving the Statute a retroactive effect upon a closed transaction and imposing upon the petitioner an arbitrary and unreasonable tax, especially with respect to the ordinary income, amounting to the taking of her property without due process of law in violation of the Fifth Amendment to the Constitution of the United States, is an important and doubtful question. *Blodgett* v. *Holden,* 275 U. S. 142, *149*; *Hassett* v. *Welch,* 303 U. S. 303, *314*; *Helvering* v. *Helmholz,* 296 U. S. 93; *Nichols* v. *Coolidge,* 274 U. S. 531, *542*; *Hoeper* v. *Tax Commission,* 284 U. S. 206, *215*. Such question has not been but should be settled by decision of this Court.

5. The question as to whether the petitioner was taxable under Sec. 167 of the Act of 1934 upon the capital gains for 1934 and 1935 under the circumstances here disclosed, is a question concerning which there has been some difference and uncertainty in the Circuit Courts of Appeals.

It was indicated that Section 167 would not apply to such a situation as this, in *Commissioner* v. *Waterbury,* 97 F. (2d) 383, *386* (C. C. A.—2), cert. denied, 305 U. S. 638, *Commissioner* v. *Grosvenor,* 85 F. (2d) 2, *3* (C. C. A.—2), and *United States* v. *Stroop,* 109 F. (2d) 891, *894* (C. C. A.—6), which decisions, however, involved Sec. 167 with slightly different language in the Acts prior to 1932. Nevertheless, a similar result involving Section 167 as well as Sec. 166 in the Act of 1934, was reached in *Corning* v. *Commissioner* (*supra*). Subsequently *Corning* v. *Commissioner* was disapproved in *Altmaier* v. *Commissioner,* 116 F. (2d) 162 (C. C. A.—6), cert. denied 312 U. S. 706, which was followed in *Graff* v. *Commissioner,* 117 F. (2d) 247 (C. C. A.—7). But the decisions in the latter two cases seem to have been based upon a misunderstanding of the effect of the decision of this Court in *Helvering* v. *Hallock,* 309 U. S. 106, *Cf. Helvering* v. *Campbell,* 313 U. S. 15, *21, 22.*

Kent v. *Rothensies,* 120 F. (2d) 476 (C. C. A.—3), cert. denied Oct. 13, 1941, where Sec. 167 was held to apply, involved an extreme situation.

The question as to whether Sec. 167 applies to the capital gains under the circumstances here involved, is one which has not been but should be settled by decision of this Court.

6. The question as to whether Sec. 167 of the Act of 1934 may be applied to tax the petitioner upon the

capital gains from these trusts for 1934 and 1935, without giving the statute a retroactive effect and imposing upon her an arbitrary and unreasonable tax amounting to taking her property without due process of law in violation of the Fifth Amendment, is an important and doubtful question which has not been but should be settled by decision of this Court. *Blodgett* v. *Holden* (*supra*); *Hassett* v. *Welch* (*supra*); *Helvering* v. *Helmholz* (*supra*); *Nichols* v. *Coolidge* (*supra*); *Hoeper* v. *Tax Commissioner* (*supra*); *Eisner* v. *Macomber*, 252 U. S. 189, *202-3*; *Gibbons* v. *Mahon*, 136 U. S. 549, *558*.

WHEREFORE your petitioner prays that a writ of certiorari issue directed to the United States Circuit Court of Appeals for the Second Circuit, to review the said judgment, and for such other and further relief as may be just.

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